Office of the New York State Comptroller

Division of Local Government
& School Accountability

Village of Flower Hill

Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

June 1, 2010 — September 30, 2011

2012M-119

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

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Dear Village Officials:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and Village Board governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard local government assets.

The following is a report of our audit of the Village of Flower Hill, entitled Internal Controls Over Selected Financial Operations. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for local government officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

Office of the State Comptroller
Division of Local Government
and School Accountability

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

The Village of Flower Hill (Village) is located in the Town of North Hempstead, in Nassau County. The Village comprises parts of Roslyn, Manhasset and Port Washington, and has a population of 4,600 residents. The Village is governed by an elected Board of Trustees (Board) which consists of a Mayor and six Trustees. The Village provides governmental services including highway maintenance, a building department, justice court, and contracted fire protection and sanitation services. These services are funded primarily through real property taxes, State aid, and user charges. The Village's general fund expenditures totaled $2.9 million for the 2010-11 fiscal year.

Scope and Objective

The objective of our audit was to review the Village's internal controls over selected financial operations for the period June 1, 2010 to September 30, 2011. We extended our analysis of budgeting practices back to 2006, the agency fund back to 2007, and records and annual audits back to 2006. Our audit addressed the following related questions:

- Did Village officials ensure that budgetary estimates for revenues, appropriations and fund balances were reasonable?
- Did the Clerk-Treasurer properly account for and maintain all moneys held in a fiduciary capacity?
- Did the Board take appropriate action to ensure that Village records are properly maintained and audited?
- Has the Board established adequate internal controls over Trustee fringe benefits?
- Has the Board delegated discretionary functions to independent contractors?
- Is access to the Village's financial accounting system appropriately controlled and monitored?

Audit Results

Village officials did not ensure that budgetary estimates were reasonable. Village officials prepared budgets that significantly underestimated revenues and overestimated expenses from 2006-07 to 2010-11 for a combined total of $8.6 million. In addition, Village officials budgeted and accounted for a $2.3 million capital project in the general fund. Although this was permissible, this caused the amounts reported to be distorted, which significantly contributed to budget variances. These budgetary practices are misleading and may lead to fiscal stress.

The former Clerk-Treasurer did not properly account for and maintain moneys held in a fiduciary capacity. Since at least 2007, the former Clerk-Treasurer remitted payroll withholdings from the agency bank account, but did not transfer corresponding amounts from the general fund to cover the payments. Therefore, she used money that should have been held in a fiduciary capacity to pay general fund expenses. In addition, the former Clerk-Treasurer did not issue press-numbered duplicate receipts when collecting agency cash and destroyed records that may have been maintained to account for agency funds. As a result, Village officials could not determine the exact liability in the agency fund. While improvements have been made in accounting for agency funds, press-numbered duplicate receipts are still not issued. As a result, there is still an increased risk that transactions may not be recorded and that errors could go undetected.

The Board did not appoint a records management officer or implement procedures to ensure that records were maintained in accordance with the Law. The former Clerk-Treasurer discarded many Village records prior to January 2009 in violation of the Law. In addition, the Board did not promptly address the deficiencies and internal control weaknesses reported by its Certified Public Accountant (CPA). As a result, the CPA could not render an opinion as to the accuracy of the Village's financial statements for three consecutive years, 2006-07 through 2008-09. Therefore, Village officials cannot be assured that all Village resources are accounted for.

The Board has not established adequate controls over fringe benefits provided to the Board. The Board adopted a Local Law ratifying benefits for the Mayor and Board members for health insurance, life insurance and long-term care insurance. However, the invoices submitted were not always for the types of insurance specifically authorized by the Local Law. For example, the Village paid $8,650 for disability income coverage and $10,620 for life insurance for the spouse of one Board member. The Village paid about $28,000 for these expenses during the 2010-11 fiscal year.

The individuals named as the Village building inspector and code compliance officer serve the Village as independent contractors rather than as public officers. While the Village generally may retain professionals as independent contractors and consultants to advise and assist Village officials and employees in the performance of their duties, unless expressly authorized by statute, the Village may not contract with a private party to perform Village functions that involve the performance of police powers or other discretionary functions.

Finally, access to the Village's financial accounting system is not appropriately controlled and monitored. The Village did not properly segregate access to the financial data application by job responsibilities, and did not assign a user account to each individual. Without limited user access rights, the integrity of the information within the financial software may be compromised.

Comments of Local Officials

The results of our audit and recommendations have been discussed with Village officials and their comments, which appear in Appendix A, have been considered in preparing this report. Village officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

Introduction

Background

The Village of Flower Hill (Village) is located in the Town of North Hempstead, in Nassau County. The Village comprises parts of Roslyn, Manhasset and Port Washington, has a population of 4,600 residents, and encompasses 1.6 square miles. The Village is governed by an elected Board of Trustees (Board) which consists of a Mayor and six Trustees.

The Mayor is the Board's presiding officer, the Village's chief executive, and the budget officer. The Treasurer is the Village's chief financial officer and is responsible for collecting, disbursing and investing Village funds. The Clerk is responsible for maintaining custody of the Village's books and records and all of the Board's official communications. The former Clerk-Treasurer was responsible for both the Clerk's and the Treasurer's duties. In April 2008, the Village hired a separate individual as Treasurer and the former Clerk-Treasurer continued as the Village Clerk. In September 2009, the former Clerk-Treasurer retired and the Village hired an Administrator who assumed the duties of the Village Clerk.

The Village provides governmental services including highway maintenance, a building department, justice court, and contracted fire protection and sanitation services. These services are funded primarily through real property taxes, State aid, and user charges. The Village's general fund expenditures totaled $2.9 million for the 2010-11 fiscal year.

Objective

The objective of our audit was to review the Village's internal controls over selected financial operations. Our audit addressed the following related questions:

- Did Village officials ensure that budgetary estimates for revenues, appropriations and fund balances were reasonable?
- Did the Clerk-Treasurer properly account for and maintain moneys held in a fiduciary capacity?
- Did the Board take appropriate action to ensure that Village records are properly maintained and audited?
- Has the Board established adequate internal controls over Trustee fringe benefits?
- Has the Board delegated discretionary functions to independent contractors?

- Is access to the Village's financial accounting system appropriately controlled and monitored?

Scope and Methodology

We examined internal controls over budgeting practices, the agency fund, records and annual audits, Trustee benefits, independent contractors and computer access of the Village for the period June 1, 2010 to September 30, 2011. We extended our analysis of budgeting practices back to 2006, the agency fund back to 2007, and records and annual audits back to 2006.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix B of this report.

Comments of Local Officials and Corrective Action

The results of our audit and recommendations have been discussed with Village officials and their comments, which appear in Appendix A, have been considered in preparing this report. Village officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, pursuant to Section 35 of the General Municipal Law. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Board of Trustees to make this plan available for public review in the Village Administrator's office.

Budgeting Practices

The Board is responsible for adopting structurally balanced budgets. The budget is a financial plan that details the Village's projected revenues and expenditures for the fiscal year and serves as spending authority for Village officials. The budget also serves as a way to communicate to taxpayers the manner in which Village officials plan to spend tax revenues. The Board is responsible for ensuring that the accounting records provide a clear picture of the Village's financial position so they can be effectively used in the budget process. In addition, the Board must ensure that its budgetary estimates for revenues, expenditures (appropriations) and fund balance are based on actual financial results from prior years along with other relevant financial data. When fund balance is a funding source in a budget, amounts budgeted for use should be both needed and available.

The Board has consistently adopted budget estimates for revenues, expenditures and fund balance that are not reasonable. Specifically, Village officials prepared budgets that significantly underestimated revenues and overestimated expenses in each of the fiscal years from 2006-07 to 2010-11 for a combined total of $8.6 million in budget variances. These budgetary practices are misleading to taxpayers and may lead to fiscal stress.

Revenues and Expenditures

Budgets must include reasonable estimates of revenues, because these estimates have a direct effect on the property tax levy. Expenditures (appropriations) are the budget estimates for the costs to be incurred during the fiscal year. Throughout the year, appropriation accounts should be used to control expenditures, keeping them within the authorized spending authority.

Officials prepared budgets that significantly underestimated revenues and overestimated expenditures in each of the fiscal years from 2006-07 to 2010-11 for a combined total variance of $8.6 million, as shown in Table 1.

Table 1: Budget Variances

Fiscal Year	Revenues	Expenditures	Total Combined Variance
2006-07	$879,877	$1,921,243	$2,801,120
2007-08	$658,915	$1,196,483	$1,855,398
2008-09	$813,966	$711,544	$1,525,510
2009-10	$1,292,904	$403,769	$1,696,673
2010-11	$287,496	$476,590	$764,086
Totals	**$3,933,158**	**$4,709,629**	**$8,642,787**

From 2006-07 to 2010-11, revenues were underestimated by $3.9 million. The underestimated revenues were primarily from building permit fees, mortgage tax revenue, and State aid for highway improvements. For example, mortgage tax revenue was estimated at $50,000 in each of the years 2006-07 to 2008-09 and at $40,000 in 2009-10 despite actual revenues of $311,640, $250,047, $175,565 and $130, 062 resulting in a four-year variance of $677,314. In addition, in 2009-10, Village officials estimated revenues of $70,000 for building permit fees but received $695,630. While the actual revenue was higher than historical trends, the revenue estimate for 2009-10 was lowered despite the actual results for prior years. Finally, no amount was budgeted for State aid for highway improvements for the years 2006-07 through 2009-10, but $627,023 in revenue was received over those four years.

Expenditures were overestimated by $4.7 million from 2006-07 to 2010-11. Including a capital project in the general fund budget contributed to the variances for the years 2006-07 through 2008-09. Also, Village officials did not use the prior year's actual results to estimate appropriations. For example, Village officials appropriated $1,021,500 in 2007-08 and $1,456,500 in 2008-09 for road maintenance even though actual expenses were only $483,481 and $820,243, respectively, or $1,174,276 less than estimated. Additionally, from 2006-07 through 2009-10 Village officials appropriated $75,000 each year for retirement expenditures despite actual expenditures ranging from $37,000 to $47,000.

Village officials provided no explanations for why the budget estimates were so poor. Consistently including unrealistic revenue and expenditure estimates in Village budgets can be misleading to taxpayers. Furthermore, when the Board's annual spending plans are based on unrealistic and unreliable estimates, it is unable to effectively manage financial operations.

Village Hall Capital Project

Village officials should use a capital projects fund to record capital project activity lasting more than one year. The budget for each capital project covers the actual period of the project, not just one fiscal year. Accounting for capital projects in a capital projects fund provides Village officials with a means to readily identify and monitor capital project activity, and avoids distorting the general fund's budget and financial results, which can adversely affect the Board's ability to budget effectively.

From 2006-07 to 2008-09, Village officials budgeted and accounted for a $2.3 million capital project for the renovation of the Village hall in the general fund. The project accounted for a large percentage of the general fund budgeted expenditures and distorted the amounts

reported as general fund expenditures. For example, the 2006-07 budget included an appropriation of $1.5 million for the Village hall renovation project, which represented 27 percent of the total $5.4 million budgeted for expenditures. Due to project delays, only $98,818 of this appropriation was actually used, causing a $1.4 million expenditure variance in 2006-07.

The 2007-08 budget also included an appropriation of $2 million for this same project, which represented 31 percent of the total budget. However, the budgetary impact for 2007-08 was not as significant because actual expenditures were similar to the amount budgeted, totaling $1.8 million, representing 34 percent of the actual expenditures for that year. In the following year, only $50,000 was budgeted for the project, but actual expenditures totaled $500,000.

When capital project expenditures are combined with general fund expenditures, it becomes difficult to budget effectively for operating expenditures. In addition, the budgets become less useful for year-to-year comparisons making it more difficult to monitor financial activities and making capital project activities less transparent to taxpayers.

Use of Fund Balance

Fund balance represents the difference between revenues and expenses accumulated over time. Officials can set aside, or constrain, a portion of fund balance for specified purposes. In addition, they can assign the unexpended surplus[1] portion of fund balance to help finance next year's budget or retain it for future use. The Village may retain a reasonable portion of fund balance as a financial cushion for unforeseen expenditures.

When fund balance is to be used as a funding source in the budget, it is expected that budget estimates are reasonable and there will be an operating deficit in the ensuing year equal to the amount of the appropriated fund balance that will be necessary to cover expenditures. It is not sound financial practice to appropriate more fund balance than is actually necessary or to appropriate more than is actually available. As shown in Table 2, from 2006-07 to 2010-11, Village officials prepared budgets that appropriated significantly more fund balance than was necessary to fund operations.

[1] The Governmental Accounting Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: nonspendable, restricted, and unrestricted (comprising committed, assigned, and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011, and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54, we will use the term "unexpended surplus funds" to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54), and is now classified as unrestrictred, less any amounts appropriated for the ensuing year's budget (after Statement 54).

Table 2: Fund Balance				
Fiscal Year	Beginning Available Fund Balance	Appropriated Fund Balance	Actual Operating Surplus/ (Deficit)	Total Available Ending Fund Balance[b]
2006-07	$3,926,676	$2,582,953	$218,167	$4,144,843
2007-08	$4,144,843	$3,766,499	($1,911,101)	$2,231,784
2008-09	$2,231,784	$2,583,537a	($1,058,027)	$1,173,757
2009-10	$1,173,757	$2,100,000[a]	($403,327)	$770,430
2010-11	$770,430	$290,000	$474,086	$1,244,516
Total		**$11,322,989**	**($2,680,202)**	

[a] Village officials appropriated more fund balance than was available
[b] General Municipal Law authorizes Village officials to legally reserve moneys for capital purposes in a capital reserve fund, subject to rules for establishing the fund and using moneys in the reserve. The available fund balance for 2006-07 excludes capital reserve amounts of $95,929. The available fund balances for 2007-08 through 2010-11 each exclude capital reserve amounts of $97,887.

The Board appropriated $11.3 million in fund balance to finance planned operating deficits. However, due to the unreasonable budget estimates as described previously, the Village never had the operating deficits that were expected. As a result, only $3.4 million in fund balance was used, and that was only in the three fiscal years (2007-08 to 2009-10) when the Village had operating deficits. In the other two fiscal years (2006-7 and 2010-11), none of the appropriated fund balance was used because the Village had operating surpluses.

We also found that the budgets for 2008-09 and 2009-10 appropriated more fund balance than was available. The available fund balance as of May 31, 2008 totaled over $2.2 million, but the budget for 2008-09 appropriated over $2.5 million. In addition, the available fund balance as of May 31, 2009 totaled over $1.2 million, but the budget for 2009-10 appropriated $2.1 million. In total, the Board appropriated nearly $1.3 million more than was available. Ordinarily this would cause the depletion of fund balance, but because of the unreasonable budget estimates for revenues and expenditures (see Table 1), the Village ended each of the fiscal years with positive fund balances.

Officials had not established policies and procedures to estimate the fund balance that would be available at year-end. Instead, the former Treasurer would use the cash balance in the Village's general fund money market account at the time the budget was being prepared, typically in January or February, as the amount of fund balance to appropriate. This practice increases the risk that the amount appropriated will be greater than the actual fund balance available three to four months later, at the end of the fiscal year.

Village officials appropriated $290,000 in fund balance for the 2010-11 budget and $300,000 for the 2011-12 budget, substantially less than

in prior years. Although, no fund balance was actually used in 2010-11 due to an operating surplus of $474,086, the amounts appropriated are more reasonable given the size of the Village's operating budget. The continued appropriation of more fund balance than is necessary, or more than is available, is not a responsible way to manage Village finances. These budgetary practices can be misleading to taxpayers and may lead to fiscal stress.

Recommendations

1. The Board should establish a policy and develop procedures for preparing realistic and structurally balanced budgets, using actual financial results from prior years and other relevant and available data. This process should include guidelines for developing budget estimates for revenues and expenditures.

2. The Board should establish a capital projects fund for all future capital projects that span more than one fiscal year to budget, record, and report multi-year capital projects.

3. The Board should establish policies and procedures for determining the appropriate level of fund balance to maintain, accurately estimating the amount of fund balance that will be available at the end of the fiscal year, and determining the proper amount of fund balance to appropriate in the ensuing year's budget.

Agency Fund

Agency funds are held by a Village in a purely custodial capacity. Agency funds typically involve the receipt, temporary investment, and remittance of fiduciary resources to individuals, private organizations, or other government entities. Payroll withholdings that are remitted to the appropriate government entities are an example of moneys typically placed in an agency fund. Moneys held in a trust or fiduciary capacity, or those that by law may be used only for stated purposes, may not be advanced to other funds. The Clerk-Treasurer is responsible for properly accounting for and maintaining all moneys held in a trust or fiduciary capacity. This includes ensuring that the receipts and records are sufficient to properly account for all agency moneys received.

The former Clerk-Treasurer maintained an agency fund into which she deposited cash and bond proceeds, ranging in amounts from $1,000 to $50,000, which she received for planning board and zoning board applications; building permits for residential, commercial and swimming pool construction; and road openings. These deposits were properly recorded in the agency fund and held in a separate account, often for several years, until the applications or projects were completed, at which time they were returned, less any applicable fees.

The former Clerk-Treasurer remitted payroll withholding tax, State pension payments, and other withholdings from the agency bank account, but did not transfer corresponding amounts from the general fund to cover the payments. For example, during 2007-08, the Treasurer made payments for Federal and State withholdings totaling $102,661[2] from the agency checking account without transferring any funds from the general fund. Therefore, bond deposit money properly deposited in the agency fund was used to pay general fund expenditures. In addition, in April 2008, the former Clerk-Treasurer closed two agency bank accounts and improperly transferred the balances, totaling $158,722, to the general fund checking account. Through these actions, the former Clerk-Treasurer improperly advanced moneys to the general fund and used the money to fund operations.

As of May 31, 2007, the Village reported a balance due from the general fund to the agency fund of $195,591. As a result of improper transfers and other improper transactions, by May 31, 2009, the

[2] Includes withholding taxes of $29,942 for Federal income taxes, $32,945 for Social Security and Medicare, $14,865 for State income tax, $18,710 for deferred compensation and $6,199 in pension contributions and loan payments.

agency account contained only $40,015 and the amount due from the general fund totaled $507,296. A summary of the net advances for the last five years is as follows:

Table 3: Agency Fund Balances			
As of May 31	Cash Balance	Due From General Fund	Total Assets
2007	$564,519	$195,591	$760,110
2008	$343,905	$428,057	$771,962
2009	$40,015	$507,296	$547,311
2010	$71,570	$170,180	$241,750
2011	$145,190	$0	$145,190

In addition, the former Clerk-Treasurer did not issue press-numbered duplicate receipts when collecting cash and destroyed any other records that may have been maintained to account for agency funds (see "Records and Annual Audits" section). Consequently, Village officials could not determine, and we could not verify, the liability in the agency fund.

Due to the lack of records, Village officials had to require applicants to provide copies of their cancelled checks and/or verify liabilities through other means before they could refund bond moneys held in the agency account. For example, in September 2010, Village officials returned $32,500 in bond moneys that was held since November 2007. The Village had no accounting record of the liability but returned the funds after the applicants produced cancelled checks as proof of payment and Village officials were able to verify the issuance of building permits through records maintained by the building department.

Village officials have recently made improvements in their procedures for collecting and accounting for agency funds, including segregating agency fund and payroll activity. The financial report as of May 2011 indicates that no advances were outstanding at that time and Village officials have indicated that they have discontinued the practice that caused the advances. However, press-numbered duplicate receipts are still not issued when deposits are received. Instead, a copy of the individual's application is given as a receipt. This increases the risk that transactions may not be recorded and that errors could go undetected.

Recommendation

4. The Board should establish a policy for managing agency funds. This policy should formalize procedures to prevent moneys held in a fiduciary capacity from being advanced to other funds, and require that press-numbered receipts be issue when deposits are received.

Records and Annual Audits

The Board is responsible for appointing a records management officer to ensure that Village officials maintain and retain financial and accounting records as required by Law. In addition, the Board is required to audit, or cause an audit, of the Village's books and records. When an audit report identifies weaknesses in internal controls, the Board should promptly implement a corrective action plan (CAP).

The Board did not appoint a records management officer. As a result, the former Clerk-Treasurer discarded many Village records dated prior to January 2009 in violation of the Law. In addition, although the records were available at the time, the Board did not promptly address the deficiencies and internal control weaknesses reported by its Certified Public Accountant (CPA) by preparing and implementing a CAP. Due to the significance of the issues reported, the CPA could not render an opinion as to the accuracy of the Village's financial statements for three consecutive years, 2006-07 through 2008-09. As a result, Village officials cannot be assured that all Village resources are accounted for.

Record Retention

Village officials are responsible for implementing record retention and disposition schedules in accordance with State law and the guidelines promulgated by the New York State Archives and Record Administration (SARA). The disposition schedules help ensure that records are retained as long as needed for administrative, legal and fiscal purposes; that State and Federal retention requirements are met; that records with enduring historical and other research value are identified and retained permanently; and that systematic disposal of unneeded records is encouraged. Generally, claims, investment and general accounting records must be maintained for six years and certain payroll records up to 55 years. Other records must be retained permanently.[3]

The Board adopted a local law in 1999 that required compliance with SARA guidelines. SARA guidelines recommend that the Board appoint a records management officer to coordinate and carry out the disposition of records in accordance with the schedules, that a record be kept to identify records that are disposed of, and that a report should be given to the Board. Officials did not implement any of these procedures to ensure compliance with the Law. Consequently,

[3] Records may not be disposed of unless the records are listed on a schedule or their disposition is covered by State laws. Record retention periods vary depending on the function of the document.

officials did not maintain the Village's financial records and reports for the period June 1, 2006 through December 31, 2008 in accordance with the Law. Village officials informed us that many records from prior to January 2009 were not available because the former Clerk-Treasurer discarded them while they were in storage during the renovation of the Village hall.

The disposal of these records was not in conformance with the record retention schedule and was done without Board authorization. As a result, only a few bank statements and cancelled checks were retained for the period June 1, 2006 through December 31, 2008. There were no invoices for payments (claims) for 2006-07 and many claims for 2007-08 were missing. Most payroll records prior to January 2009 and many other source documents, including cash receipt logs and monthly and quarterly financial reports, were not available.

Officials have not been able to reconstruct the records for these years.[4] The Administrator and Treasurer provided us with the limited records that were available for June 1, 2006 to December 31, 2008, and the Treasurer requested bank statements and cancelled checks from their banks. The Village's CPA provided us with his working papers and copies of Village records he used for the annual external audit engagements for 2006-07 and 2007-08. While we found many discrepancies in record keeping, the transactions reviewed appeared to be for legitimate Village business. However, due to the poor condition of the records, and the lack of supporting documentation, Village officials cannot be assured that all Village resources were accounted for or appropriately used.

Annual Audits and Corrective Action

Local governments that receive audit reports with recommendations should prepare and implement a CAP, which provides an opportunity for the governing board[5] to communicate how audit findings and recommendations will be used positively to improve operations and internal controls. The Law also requires Village officials to post their most recent audit reports on the Village's website, if practicable.

The Village contracts with a CPA firm to audit the Village's financial statements. For 2006-07 through 2008-09, the CPA reported that the Village's lack of internal control and inadequate accounting records precluded the CPA from expressing an opinion on the financial statements.

[4] Due to a change in accounting software, officials cannot access electronic records that may reside on the Village's servers for the period prior to January 2009.

[5] Although key officials and managers within the Village may design implementation plans, the Board with the audit committee (if applicable) should review and approve the CAP.

The CPA also issued management letters to the Mayor and the Board in each of those years communicating significant deficiencies and material internal control weaknesses. The letters recommended that the Village develop accounting policies incorporating key internal control procedures for all major accounting areas.

Despite the CPA's disclaimers of opinions for three consecutive years, and the serious nature of the deficiencies in the management letters, the Board did not publicly or formally address these problems or prepare a CAP. Because the former Clerk-Treasurer disposed of many of the records from these years (see "Record Retention"), officials have not been able to reconstruct the records for these years, and therefore have no assurance that all errors and irregularities were detected and corrected.

In a letter to the Mayor and the Board dated June 2010, the current Treasurer responded to the CPA's management letter for the fiscal year ending May 31, 2009 and detailed the corrective actions Village officials had implemented. The Board took no formal action to accept this as a CAP. The CPA issued unqualified opinions of the financial statements for 2009-10 and 2010-11, and the accompanying management letters cited significantly fewer deficiencies. While the CPA's reports are available at the Village hall, they are not posted on the Village website.

It is important for the Board to fulfill its fiscal oversight responsibilities and properly monitor financial operations. The Board's formal and public adoption of a CAP sends a positive message to the public and to employees about the tone at the top regarding the Board's commitment to safeguarding assets and making government operations more effective and transparent.

Recommendations

5. The Board should appoint a records management officer and implement procedures to ensure that Village officials comply with the record retention and disposition schedules in accordance with State law and the guidelines promulgated by SARA.

6. The Board should formally respond to audit recommendations by preparing and implementing CAPs.

7. Officials should post the most recent audit reports on the Village website.

Trustee Fringe Benefits

General Municipal Law (GML) authorizes a village to contract for health insurance for officers and employees and their families. A Village is also authorized under GML to provide group life insurance to its officers and employees. Therefore, the Board may by resolution provide these benefits. Fringe benefits not authorized by State law can, in some cases, be authorized by local law. The Board is responsible for establishing internal controls to ensure that fringe benefits are provided in accordance with applicable laws and in compliance with income tax requirements.

The Village is governed by a Board of Trustees that consists of a Mayor and six Trustees. The Mayor and the Trustees do not receive salaries and one Trustee does not receive any Village provided fringe benefits. The Village spent a total of $95,600 during the 2010-11 fiscal year on insurance premiums for the Mayor and the other five Trustees.[6]

On March 6, 2006, the Board adopted a resolution to provide health insurance benefits or an appropriate alternative to the Mayor and the Trustees. However, the resolution did not define what an appropriate alternative was. On August 8, 2011, the Board adopted a Local Law ratifying previously approved benefits for the Mayor and the Trustees, and specified the benefits as health insurance, life insurance or long-term care insurance previously authorized. On January 9, 2012, the Board voted against a resolution to discontinue providing benefits to the Mayor and the Trustees.

The Village provided health insurance benefits in accordance with the Law. However, the Village paid about $28,000 during 2010-11 for various types of insurance without ensuring they were in accordance with the Law. Two Board members or their spouses independently contracted for insurance and submitted invoices for payment for this insurance. However, the invoices submitted for reimbursement were not only for Board members, or only for the types of alternative insurance specifically authorized by the Local Law. For example, the Village paid $8,650 for disability income coverage for the spouse of a Trustee, which was not an alternative insurance specifically authorized by the Local Law. In addition, the Village paid $10,620 for life insurance for the spouse of a Trustee.

[6] This includes health insurance benefits that were provided to the Mayor and three Trustees.

Because the Village did not establish controls for providing benefits to the Trustees, there is no assurance that the benefits that are being paid for comply with the Local Law or other applicable laws. Further, the Village paid the insurance companies directly, and did not issue tax documents to these individuals. The Village should contact the Internal Revenue Service (IRS) to determine whether it has complied with income tax requirements for these transactions.

Recommendations

8. The Board, in consultation with the Village attorney, should determine whether all benefits provided to the Board have been duly authorized by the Local or State Law.

9. The Board should not approve the payment of claims for insurance expenses that have not been duly authorized.

10. The Board should ensure that past payments for insurance expenditures were in accordance with the law and should seek to recover any unauthorized payments.

11. Officials should consult with the IRS to ensure that they are in compliance with income tax requirements for these transactions.

Independent Contractors

A village generally may retain professionals as independent contractors and consultants to advise and assist officials and employees in the performance of their duties. In addition, a village may contract with private entities for the performance of functions that are purely ministerial in nature. However, unless expressly authorized by statute, a village may not contract with a private party to perform village functions that involve the performance of police powers or other discretionary functions. The Village building inspection and code enforcement functions have certain duties and responsibilities that involve the performance of police powers to enforce local building and zoning laws, and the exercise of judgment or discretion, which cannot be delegated to an independent contractor.

Each year at its reorganization meeting, the Board appoints individuals to act as Code Compliance Officers for a one-year term. The individuals that perform the building inspection and code enforcement duties each took an oath of office.[7] While these appointments would indicate that the Board intended to have these individuals act as Village officers, we also found evidence that these individuals may have been engaged to perform building inspection and code enforcement functions as independent contractors, rather than as officers.

In 1998, the Village contracted with an individual to be the building inspector. During our audit period, this individual was paid $91,742. Under the contract, the building inspector is responsible for inspection of buildings and structures to assure compliance with the codes, interpretation and enforcement of the Village's building code and building zone ordinances, handling required paperwork for completion of projects, issuing permits and certificates of occupancy, and issuing summonses for Village Code violations. Although this individual has performed services for the Village since 1998, and received increases in compensation, no additional contract has been approved by the Board. The contract expressly states that the building inspector is not a Village employee. The contract classifies the building inspector as a consultant working independently and at his own direction.

In 2008, the Village contracted with a corporation to provide code enforcement services. The contract names an individual employee of

[7] While the resolution appointing them states they are appointed as Code Compliance officers, the oaths of office state they will discharge the duties of Building Inspector and Code Enforcer.

the corporation who is to furnish code enforcement services. During our audit period, the Village made payments to this corporation totaling $101,373. Under the contract, code enforcement services include patrolling Village streets, issuing warning letters and summonses for Village Code violations, meeting and coordinating with the Village Prosecutor, and delivering to the Village Clerk-Treasurer reports of enforcement actions. The individual named in the contract issued summonses for violations of local ordinances such as the failure to display a valid sticker on a work vehicle, parking violations, noise violations, dog barking, and occupying a building without a certificate of occupancy. The contract expressly declares that the corporation is an independent contractor and states that the corporation, not the Village, is responsible for establishing the named individual's working hours. Although this corporation has been paid to provide code enforcement services to the Village since 2008, no additional contract has been approved by the Board.

In light of the factors, which indicate an independent contractor relationship with the individuals performing the building inspection[8] and code enforcement functions, the Board cannot be certain that all discretionary Village functions and police powers are being performed by Village officials, and not independent contractors.

Recommendation

12. The Board, with its counsel, should review the Village's relationship with the individuals performing the discretionary building inspection and code enforcement functions. The Board should ensure that anyone who performs these duties in the Village meets all the requirements for holding Village office, including being properly appointed to the office, taking an oath of office and being compensated through payroll with appropriate deductions, and are not engaged as independent contractors.

[8] Subsequent to our audit period, the Village hired the "Building Inspector" as an employee in the position of Superintendent of Buildings.

Computer Access

User accounts for accessing computer systems should contain user-specific information such as usernames, passwords and access rights to files, applications and other computer resources. Because user accounts provide a means to identify and differentiate among users they should never be shared. Furthermore, to ensure the proper segregation of duties, user accounts should be assigned so that employees have access to only those functions that are necessary to fulfill their job responsibilities and prevent them from being involved in multiple aspects of financial transactions. Because a system administrator generally has oversight and control of a computer system, system administrative rights should only be assigned to someone who does not perform the majority of the accounting transactions. It is important that Village officials generate and review audit logs to identify and address any unauthorized errors or irregularities that could occur.

The Village uses a financial software application to record financial transactions and produce financial and budgeting reports. However, the Village did not properly assign user accounts. For example, the Treasurer has administrative access to the financial software application even though she performs the majority of accounting transactions. With administrative rights, the Treasurer has the ability to view, add, delete, and modify records in all functions in the financial software, grant user access, override controls and make changes to the system. In addition, three individuals share a user account to record cash receipts. Finally, although the software has an audit log function that can produce reports to monitor user access, it was not turned on.

Because of these computer access weaknesses, we reviewed a sample of 135 cash receipts totaling $117,000[9] and traced them from the daily receipts register to bank deposits, to verify the integrity of the receipt sequence and investigate any gaps. All receipts were deposited complete and intact and all sequential receipt numbers were accounted for. However, the assignment of administrative access to the Treasurer and the sharing of user accounts significantly increase the risk that errors or irregularities could occur and/or that inappropriate activity may not be traceable to a single user. Furthermore, without the review of audit logs, the likelihood that Village officials could detect such activity is diminished.

[9] We used a random number generator to select ten days during the audit period.

Recommendations

13. Village officials should assign system administrator rights to an individual who does not perform the majority of accounting transactions.

14. Village officials should ensure that each employee is assigned a unique user account and that employees do not share user accounts.

15. Village officials should activate the audit log function, and designate someone to periodically print and review audit logs.

APPENDIX A

RESPONSE FROM LOCAL OFFICIALS

The local officials' response to this audit can be found on the following pages.

Village of Flower Hill

Audit Response Letter

This document has been prepared in response to the audit performed by the New York State Office of the Comptroller ("the auditors") of the Village's internal controls over selected financial operations for the period June 1, 2010 through September 30, 2011, budgeting practices dating from 2006, Agency Fund dating from 2007 and records and annual audits back to 2006.

Budgeting Practices

Revenues and Expenditures

Identified Issue:
The auditors found that "The Board has consistently adopted budget estimates for revenues, expenditures and fund balance that are not reasonable...officials prepared budgets that significantly underestimates revenues and overestimated expenses in each of the fiscal years from 2006-07 to 2010-11." The auditors felt that these practices were "misleading to taxpayers and may lead to fiscal stress."

Response:
The Board of Trustees recognizes the prior problems identified above and all personnel involved with Village finances have targeted these issues. Any concerns that existed with the historical data have gradually resolved as the Village has put new procedures in place and as increasingly accurate data is utilized. In late 2008 the Village started subscribing to [redacted] accounting software which tracks all revenues and expenditures resulting in an accurate picture of the Village's finances. All accounts are reconciled monthly. The Village uses generally accepted accounting principles and has established policies and procedures which provide accurate revenue and expenditure estimates which in turn are used in the annual budgeting process. From 2009 to the present, the Village's budgeting practices have been in accordance with the Comptroller's guidelines. As a result, in each fiscal year since 2009-10 the Village's independent certified public accounting firm has issued unqualified opinions of the Village's financial statements while noting significantly fewer deficiencies in the management letters. Further, by the 2011-12 fiscal year revenue and expense estimates were within an acceptable range of accuracy for budget preparation.

Village Hall Capital Project

Identified Issue:
The auditors found that the Village did not use a capital projects fund for the multi-year renovation/expansion of the Village Hall but instead made the expenditures from the general fund. The capital project took place over four years, using monies from the

general fund which led to the annual budgets for those years showing distortedly large expenditures.

Response:
Although it is permissible to include multi-year capital projects in the general fund, for any future capital projects lasting over a year the Village will create a separate capital projects fund so as to make it easier to monitor, record and report on financial activities for any multi-year capital projects and more clearly present to the public what is being spent.

Use of Fund Balance

Identified Issue:
The report states that from 2006 to 2011 budgets were prepared that appropriated a much larger fund balance than was necessary to fund operations.
Response:
The Board of Trustees has addressed this concern as evidenced by the 2010-11 and 2011-12 budgets. The fund balance in each of these budgets has been substantially reduced from previous years. Additionally, the Mayor and Board intend to establish a fund balance policy at the next meeting of the Board of Trustees.

Agency Fund

Identified Issue:
The auditors found that deposits to the general fund and agency fund were not properly categorized nor were payroll witholdings transferred to the general fund to cover the expense. They also found that press numbered receipts were not issued for agency fund collections.

Response:
To the extent concern was raised by the auditors regarding Trust and Agency accounting practices, the Village has targeted and addressed this issue as well. Money that was believed categorized incorrectly has been accounted for and properly categorized. The Village uses [redacted] accounting software for the intake of all revenue with two exceptions. Under certain circumstances the Village requires the submission of a deposit or a bond. For example, an applicant before the Board of Zoning Appeals will be required to submit a deposit to cover costs incurred by the Village related to the hearing. Upon completion of the hearing the unused portion of the deposit is returned to the applicant. As a second example, the Village may require the submission of a bond by an applicant who is conducting a building project within the Village. Upon completion of the project, the Village releases the bond. The Treasurer maintains a separate spreadsheet and record for all amounts collected as deposits and as bonds. The Village maintains a separate Trust & Agency Account for the deposit of these funds. The Village has ordered press-numbered receipt books to be used when bond deposits are received.

Records and Annual Audits

Record Retention

Identified Issue:
The auditors found that for the period June 1, 2006 through December 31, 2008 the Village did not adhere to the records retention guidelines of the New York State Archives and Records Administration (SARA).

Response:
Beginning in late 2008 the Village began to address these issues. In September 2008, the Board hired a new Village Administrator who assumed the duties of Records Management Officer. The Board of Trustees will formally appoint the Village Administrator as Records Management Officer at its next meeting. A record retention system that follows the SARA guidelines for records retention and dispositions under the MU-1 schedule has been in place since 2009. The Records Management Officer (RMO) keeps a log of all the Village's records. All records that are disposed of are recorded as per SARA guidelines. Additionally, as per the auditor's recommendations, beginning this year the RMO will provide an annual report to the Board of Trustees identifying any records that have been discarded during the year.

Annual Audits and Corrective Action

Identified Issue:
The report states that from 2006-07 to 2008-09 the Village's independent CPA firm annually audited the Village's financial statements. During those years the CPA reported to the Village that they were unable to express an opinion on the financial statements of the Village due to a lack of internal control and inadequate accounting records. They issued management letters to the Mayor and Board that outlined these deficiencies and made recommendations for the development of accounting policies and internal control procedures.

Response:
The Village Treasurer and Board have addressed these concerns. This is best indicated by the fact that since the 2009-10 fiscal year the Village's independent CPA has issued unqualified opinions of the financial statements with significantly fewer deficiencies in the management letters.

Also, although the financial statements and CPA's reports were available for review at the Village Hall, they were not previously posted on the Village web site. The Village will post the financial statements and CPA reports. The budget and the tax roll are currently posted on the Village web site. The Board will formally respond to audit recommendations and implement the recommendations to the extent feasible.

Trustee Fringe Benefits

Identified Issue:
The audit report raised concern that in 2010-11 the Village paid for insurance that was not specifically identified in a local law adopted by the Village ratifying the provision of certain fringe benefits. Specifically, the report noted that a Trustee's spouse's disability income coverage and life insurance for a Trustee's spouse were not identified in the local law..

Response:
Under the General Municipal Law a Village Board can authorize by resolution the provision of certain benefits to itself including health insurance. The Board is permitted to provide for other benefits by Local Law. Such benefits may include the types of insurance identified above. Further, the Village Board may ratify whatever acts it could have authorized in the first instance with the same effect as though properly done under the previous authority. The March 6, 2006 resolution by the Board for the provision of health insurance or an appropriate alternative was vague in that the resolution did not define what an "appropriate alternative" was. On August 8, 2011 the Board passed a Local Law ratifying previously approved benefits. This Local Law specifically included health, life and long term care insurance, but did not include the cost of disability income insurance and life insurance the Village had incurred for the spouses of two Trustees. The Board appreciates the need to address this open issue expediently and has made doing so a primary focus. The Board met on December 3, 2012 to discuss this issue and will continue to do so until an appropriate corrective action is decided upon.

Further, the Board has adopted a termination date for the benefits ratified by Local Law on August 8, 2011, the Board adopted a Local Law on December 3, 2012 which in part sets a termination date of May 31, 2012:

"SECTION ONE. AMENDING CHAPTER 1 TO ADD A TERMINATION DATE"
§ 1-20. Establishment of termination date for the provision of benefits for trustees of the Village and Ratification of prior grant.

Add the words "and shall terminate as of May 31, 2012." at the end of the section.

This Local Law terminates all Village-paid fringe benefits to Board members, setting an end date for the provision of benefits in accord with the recommendation in the audit report.

Identified Issue:
The audit report raised a question as to tax implications involved in the direct payment by the Village to the insurance companies for the cost of insurance without issuing tax documents to the recipients of the insurance.

Response:
In accord with the recommendation by the auditors, the Village will work with its certified public accountant and will check with the Internal Revenue Service to determine if the transactions complied with all income tax requirements.

Independent Contractors

Identified Issue:
The auditors determined that the individuals hired by the Village to perform Code Enforcement and Building Superintendent duties were in fact performing duties that were police powers and other discretionary functions. The individuals were hired as independent contractors and the enforcement of building and zoning laws, and the exercise of judgment of discretion, cannot be delegated to an independent contractor.

Response: On January 9, 2012 the Village obtained approval from Nassau County Civil Service to hire an individual to serve as Superintendent of the Building Department thus creating an employee position. On November 28, 2012 the Village obtained approval from Nassau County Civil Service to create a part time Code Enforcement Officer position to be filled upon Board approval on December 3, 2012 with an individual serving in an employee position.

Computer Access

Identified Issue:
The Village Treasurer has the administrative rights to the financial software even though she performs the majority of the accounting transactions. Although the audit of the cash receipt trail was complete and intact, improvement to the oversight process would be appropriate.

Response:
Assigning administrative access to the Treasurer for oversight while assigning the performance of accounting transactions to another employee is not feasible given the small number of employees in the Village office. We believe we can arrange an alternate method of monitoring that will meet the concern raised by the auditors. We plan to ask the company that manufactures our accounting software to produce a system which creates an audit log. A member of the Board of Trustees can then be assigned to regularly review the audit log for accuracy.

Identified Issue:
Although user-specific information is in effect for each individual computer user on the Village server, the financial software currently in use by the Village does not allow for multiple users.

Response:
The financial software currently in place only allows for two users. As such, it is not possible for each user to have their own log-in identity. To address this issue, in the future any member of the office staff who receives a payment will create a receipt which includes his or her initials. Any payment received can then be monitored and be included in the audit log.

Conclusion

We would like to thank the audit team for their hard work and effort in creating the report. The entire Board of Trustees and staff are working toward implementing solutions to all the issues raised by the auditors and believe their comments and suggestions have made the Village of Flower Hill a more viable and secure entity.

Elaine Phillips
Mayor, Village of Flower Hill
December 10, 2012

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard Village assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial condition, Board oversight, claims processing, purchasing, payroll and information technology. During the initial assessment, we interviewed appropriate Village officials, performed limited tests of transactions and reviewed pertinent documents such as Village policies and procedures, Board minutes, and financial records and reports. In addition, with the help of Village personnel, we obtained information directly from the computerized financial databases. This approach provided us with additional information about the Village's financial transactions as recorded in its databases.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft, and/or professional misconduct. We then decided upon the reported objective and scope by selecting for audit those areas most at risk. We selected budgeting practices, the agency fund, records and annual audits, Trustee fringe benefits, independent contractors and computer access for further audit testing. We performed the following procedures:

- We reviewed the Village's Annual Update Document, annual budgets and accounting records to ascertain if budget estimates were reasonable.

- We reviewed records including general ledger transaction reports, cash disbursement journals and bank statements to understand the cause of excessive amounts due from the general fund to the agency fund.

- We interviewed Village officials, and reviewed Board minutes and selected supporting documentation to understand Village policies and procedures.

- We reviewed the reports issued by the Village's Certified Public Accountant (CPA) including the annual statements and management letters from 2006-07 through 2010-11 to understand the Village's financial condition and operations.

- We interviewed the CPA and reviewed work papers to understand the Village's financial condition and operations.

- We reviewed Board minutes, local laws, and insurance payments to ascertain if there were adequate internal controls over Trustee fringe benefits.

- We reviewed written agreements with and payments to independent contractors as well as documentation pertaining to their duties to determine if discretionary authority was delegated to independent contractors.

- We interviewed officials regarding job responsibilities and audit logs, reviewed user permission reports, and observed user access rights in the accounting system to ascertain if they were properly controlled and monitored.

- We reviewed a sample of 135 randomly selected cash receipts and traced them from the daily receipts register to bank deposits, to verify the integrity of the receipt sequence and investigate any gaps.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX C

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